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Product Brief

Confectionery product

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Report Highlights:

China's confectionery market has been steadily growing for the past 5 years, and this trend is expected to continue into the future. We hereby mainly discuss sugar confectionery and chocolate confectionery products, and analyzes constrains and opportunities for U.S. exporters.

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Confectionery report-Whole China Draft

• Introduction

China's confectionery market has been growing steadily for the past 5 years, and this trend is expected to continue into the future. In the premium market, imported products and products produced in foreign companies' local production facilities dominate the market, such as Dove chocolates from Effem Foods (Beijing) Co.Ltd (Mars Co.) and Alpenliebe candy products produced by Perfetti Van Melle China Co, Ltd. Primarily European, Japanese and Korean companies dominate the imported confectionery product market (those without local production facilities). There are few U.S. players in this category.

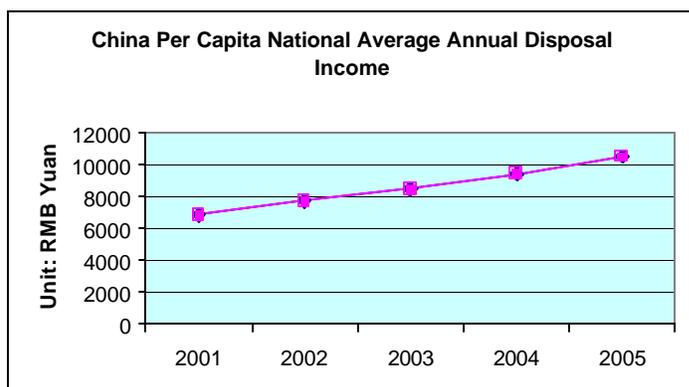
The following brief will examine China's confectionery market, especially the imported products market, and analyze the opportunities and constraints for U.S. confectionery companies. Our brief mainly discusses sugar-based and chocolate confectionery products.

• Market analysis

In 2005, the output value of sugar and chocolate confectionery products surpassed 30 billion RMB (US\$3.8 billion). East China (centered around Shanghai) is not only the leading sales region but also the flagship area in China. Greater demand, a receptivity towards new products and higher brand loyalty makes it the preferred entry point for new products.

1. Main drivers for growth

♣ Increase in disposable income



Source: China statistical yearbook

The sustained increase in per capita income in China has made some expensive products like imported confectionery products more affordable to a larger part of the population, especially for consumers in larger cities.

♣ Original consumption volume is low

China's annual per capita sugar and chocolate confectionery consumption is 0.7kg, equal to

just 0.1% of the consumption volume of developed countries such as the U.S. (4.3kg per capita), and Japan (1.4kg per capita) and just one-third of the average world per capita consumption volume. For chocolate products, annual per capita consumption in developed countries is 10kg, while in China it is only 50g. With increases in disposable income, there is a huge potential for consumption growth in this market.

♣ Gift-giving tradition

According to anecdotal evidence, gift consumption comprises about 40 pct of total candy sales. It extends from wedding ceremonies to major festival occasions like the Spring Festival (Chinese New Year), Christmas, Valentine's Day, etc. With an estimated 20 million couples getting married each year in China, if each couple purchased RMB500.00 (US\$63.00) in

up



candies and chocolates for gift-giving, it would add up to a RMB10 billion (US\$1.3 billion) market in this particular category alone. Specialty candy and chocolate stores have recently appeared in China targeting this niche high-value market.

♣Functional confectionery products attracting new consumers

Catering to the needs of health-conscious consumers, more functional products have appeared in the market. Adding vitamins, nuts, herbal ingredients etc, to confectionery products can meet both the energy and nutritional demands of consumers. Men and particularly older people, who were not confectionery products consumers in the past, have started to join this consumer group. Sugar-free products targeting diabetics also have huge potential in this market. Many people, especially in the large affluent cities of China, are afflicted with diabetes, thought to be an unfortunate consequence of the higher incomes that have changed people's standards of living and especially their diets.

• Consumer analysis

♣Taste

In general, Chinese consumers prefer less sweet and milky-flavored confectionery products. One of the key successful factors for Alpenliebe brand candy products (produced by Perfetti Van Melle China Co.Ltd) is their taste. They have added some salty flavoring to their products, so it is not too sweet tasting nor rich in milky flavor; this formula is well accepted in the Chinese market.

♣Packaging



Small, convenient and elegant packaging is welcomed in China. Confectionery products are still regarded as a catalyst for weight gain and unhealthy for teeth, especially for children. Parents will closely monitor their children's intake of sweets, and not let them eat too much. One or two small candies or chocolate pieces will be given as a reward for good behavior, but never too much. As for weight-conscious women, they are also more cautious about their volume of sweets consumption. These two groups are the main

consumer groups for confectionery products. Therefore small, convenient and elegant packaging is quite important for confectionery products. This type of packaging is especially important in gift-giving occasions; it not only facilitates a festive atmosphere, but will also be a face-gaining gesture for the gift-giver.

♣New flavor, functional products are welcomed by consumers

With the increasing living standards, people now have a greater variety of products to choose from, and they prefer products that meet their flavor and nutritional demands. According to

a survey conducted among heavy chocolate consumers, such products should express their pursuit of fashion, quality, social status and nutrition.

♣Consumer behavior

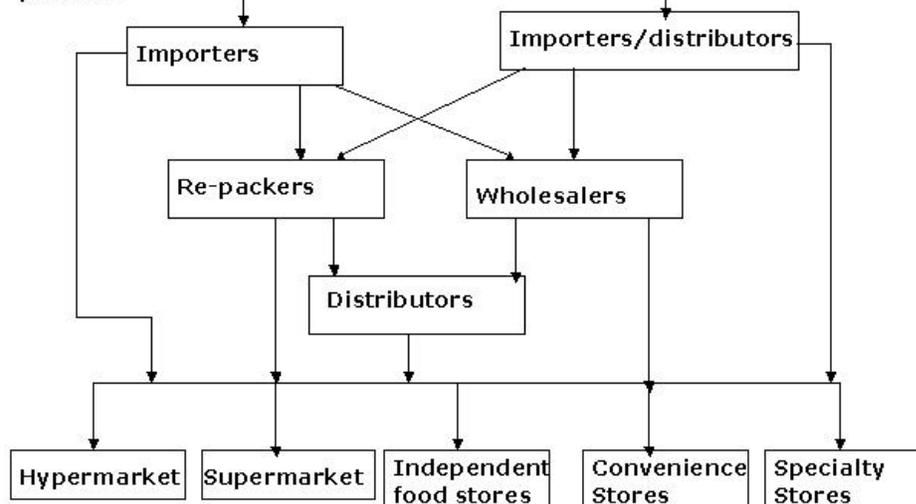
Confectionery products are still treated as seasonal treats in China. Winter is the peak sales period for most chocolate products; sales start to pick up in November and continue climbing into December, January, and February (Chinese New Year), then decline in March and April. Based on ATO trade interviews, after April, most importers will stop importing chocolate products due to the high distribution costs and low seasonal demand.

♣Promotion activities

Besides advertising, free tastings are still the most effective way to promote confectionery products in the hypermarkets and supermarkets of China.

• Distribution Channels

Channel Evaluation: Distribution channels for confectionery import products



Source: Analysis based on trade interview

Hypermarkets and supermarkets are the main sales venues for confectionery products in China. Total sales value through supermarkets and hypermarkets accounted for about 54 pct of the total sales value in 2005, up from 53 pct in 2004. (Source: Euromonitor)

The retail sector is expanding at such a rapid pace that store numbers can change almost on a weekly basis. Fast expansion greatly facilitates product availability and distribution of confectionery products. The following table provides a rough outline of the current state of the retail industry in China.

Table 4. Top Food Retailers						
Company	Ownership	2004 Revenue (million RMB)	Stores 2004	Stores 2005*	Business Line	Location
Lianhua	China SOE	30,681**	3,123	3,377	Super/Hypermkt Convenience	Nationwide
Hualian	China SOE	21,518**	1,693	NA	Super/Hypermkt Convenience	Nationwide
Carrefour China	France JV	16,241	62	72	Hypermarket	Nationwide
Beijing Hualian	China SOE	16,000	70	NA	Hypermarket	North China
Suguo	China JV	13,880	1,345	NA	Supermkt/Conven	Jiangsu/Shandong
Nonggongshang	China SOE	13,703	1,232	NA	Super/Hypermkt Convenience	East China
Beijing Wumei	China Pvt	13,277	608	NA	Supermkt/Conven	Beijing/Hebei
Trust Mart	Taiwan JV	12,000	88	90	Hypermarket	Nationwide
Huarun Wanjia	JV	11,014	476	NA	Department	
RT-Mart	Taiwan JV	9,500	40	NA	Hypermarket	Nationwide
Xinyijia	China Pvt	8,500	58	NA	Department	
Wal-Mart	US JV	7,635	43	47	Hypermarket	Nationwide
Parkson	HK JV	7,400	30	NA	Department	Nationwide
Lotus	Thail. JV	7,394	41	49	Hypermarket	Nationwide
Hymall/Tesco	UK/Taiwan JV	7,000	31	39	Hypermarket	Nationwide
Metro	Germ. JV	6,459	23	29	Hypermarket	Nationwide

Source: China Chain Store Franchise Association, except * obtained through direct contact with chains, and ** from Shanghai Statistical Yearbook, 2005.

Despite this rapid expansion, imported product share remains extremely small even in these stores, typically accounting for less than 1 pct of SKUs. Flagship hypermarkets geared to expatriates carry a larger number of imports, though typically still under 5 pct of SKUs. Distribution is a major problem. Retail distribution channels have not grown to match the number and quality of retail outlets. With some notable exceptions, distribution is handled on a store-by-store or city-by-city basis, with stores receiving most imports through a local distributor. Because of their relative size, larger stores are able to negotiate highly favorable terms that include free return of unsold products, high listing fees for new products, and better credit terms. The market risk is effectively passed onto the distributor, which makes distributors less likely to introduce new products that potentially might not sell. The inefficiencies of the cold chain pose a major constraint for chocolate confectionery products. According to ATO's interviews with major retailers, chocolate products usually occupy 80-90 pct of imported confectionery products on retailer shelves, while candy is relatively small.

The peak sales season for chocolate confectionery is from December to February and the slack season is from June until September; this is related both to consumers habits and the cold chain problem. There is a lack of well-equipped logistics companies that can meet the small-sized orders from each retailer store and at the same time offer quality services, especially during the summer. The good news is that the retailers ATO interviewed were optimistic about sales prospects for imported confectionery items, especially chocolate products, generally reporting 20-40 pct sales increases for those items. Retail price for chocolate products usually range from RMB9.00 (\$1.15) to RMB20.00 (\$2.56) per 100g, and or gift packages RMB150.00 (\$20 plus) per 200g to 250g. In a nutshell, price varies based on weight, packaging, quality (cocoa content) and brand.

• Key Players In The Market

In the imported confectionery product market, those from Europe, Japan and Korea are the most popular. Products from U.S. make up a smaller share of total sales.

♣European players



Europe is well known for its chocolate and its associated culture of fine foods; for consumers, it is not only a product choice, but also shows their appreciation of foreign culture, and represents their pursuit of a higher quality of life. Their product taste and brand awareness are perceived to be better than American products. American products are generally too sweet for Chinese consumers and the packaging too simple. Chocolate products from Belgium, Switzerland, Italy, Germany and France are the major import sources for retailers.

♣Japanese and Korean players

Japanese and Korean people have tastes similar to Chinese consumers. The Japanese especially prefer delicate tastes and small, convenient and elegant packaging. Japanese confectionery makers conducted

extensive market research in China before introducing new product lines. For instance, the Morinaga company, makers of Hi-Chew candy products, first did extensive market research work, organized focus groups in NingBo (near Shanghai) to test different flavors for their products, then began developing their market in Shanghai, Hangzhou, and Ningbo.

♣U.S. players

Confectionery products from the U.S. are generally regarded as high quality products, primarily due to the overall higher image of U.S. food products in China. Based on interviews with the trade, U.S. products need to be modified in terms of taste (less sweet) and packaging to tailor to the local preferences.

In addition, the shelf life for U.S. products is usually only 6-9 months, which is shorter than the European product shelf life of up to one year. According to ATO interviews with importers, after placing an order with a U.S. company, it generally takes 2 months for production and transportation to China, then another month to clear customs and obtain the health certificate from the "Entry-Exit Inspection and Quarantine Bureau" in China. The general rule for most retail shops is that they will not accept products that are more than halfway to their expiration date. For the U.S. products with a shorter shelf life, this means a shorter selling period for Chinese importers and distributors, adding further risk to them.

The last point mentioned by most local Chinese importers concerns the payment terms. U.S. exporters usually ask for an L/C on sight or payment before shipping, while European exporters have more flexible payment terms such as 90 days L/C, which offers a kind of financing for Chinese importers, since most of them will not receive payment from their retailers clients for up to 45 days or even 2 months after delivery.

See appendix for SWOT analysis of U.S. confectionery products

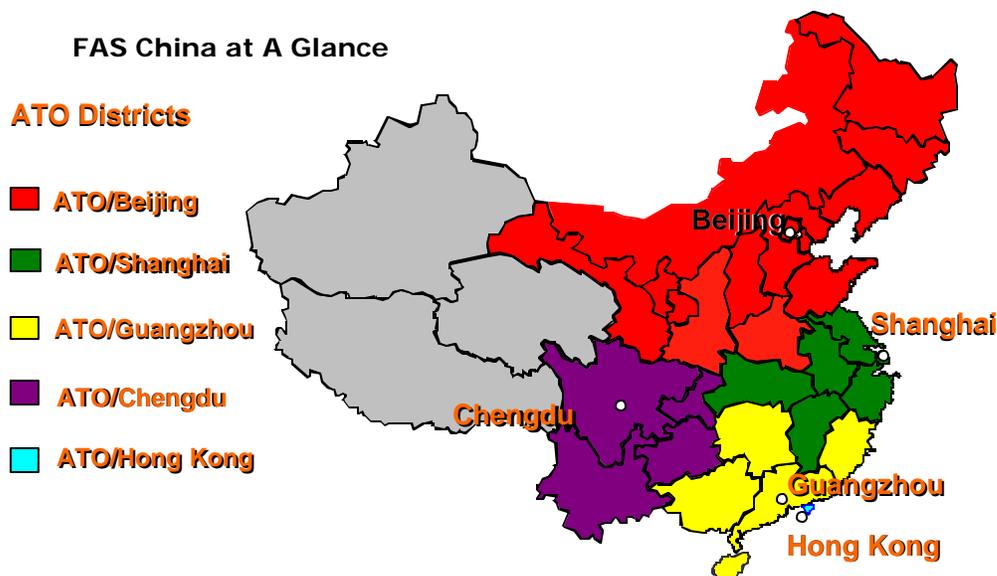
- Suggestions

The confectionery business is a traditional one in China, except for products from local manufacturers and joint ventures; many foreign imported products are now available in China. To enter into this market, we suggest the following:

- ♣Conduct market research first, to learn the preferences in taste, packaging, concept and the price range of products in the local market.
- ♣Arrange focus groups to test your product flavors.
- ♣Limit your efforts first to the key markets (i.e., Beijing, Shanghai and Guangzhou). China is such a huge market with fragmented distribution networks that we strongly suggest that you first focus on these key markets, then develop your market share in other areas.
- ♣Develop a long-term strategy for this market; invest in product innovation and packaging improvement.
- ♣IPR issue. Pre-register your patent in any new technology used in the product or in the packaging, otherwise it will soon be copied by local manufacturers, especially the packaging.

- Marketing assistance in China-ATO/Shanghai

The Agricultural Trade Office in Shanghai (ATO/Shanghai) is one of four FAS offices located in China to provide marketing support for U.S. companies. Other FAS offices include ATOs in Beijing, Guangzhou, a new office opening in Chengdu (Summer 2007) and the Agricultural Affairs Office in Beijing. ATOs provide a broad range of market development activities, promotional and support services. Companies interested in marketing their products in China should contact the appropriate ATO. Contact information is included at the end of this brief.



ATOs support activities that include trade networking events, trade shows, trader education seminars, chef education programs, consumer education activities, menu promotions, retail promotions and multi-level activities that integrate one or more of these activities together. Contact ATO/Shanghai directly for a current list of upcoming activities.

- Contact Information

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Appendix

SWOT Analysis of U.S. Confectionery Products

<p>Strength</p> <ol style="list-style-type: none"> 1. Positive product image among consumers 2. Enjoy technical advantages in development of new, innovative products 	<p>Weakness</p> <ol style="list-style-type: none"> 1. Taste needs to be modified; not too sweet 2. Packaging: small and elegant packages are preferred in China 3. Low awareness, lack of promotion and advertising 4. Considering the distribution costs and consumption habits, confectionery products are still seasonal products here. 5. Shorter product shelf life 6. Inflexible payment terms for Chinese importers
<p>Opportunity</p> <ol style="list-style-type: none"> 1. Chinese consumer rising incomes enlarge the pie for imported confectionery products 2. Consumers would like to have more choices, and try different products 	<p>Threat</p> <ol style="list-style-type: none"> 1. Competition from Europe, Japan, Korea 2. Local producers are catching up quickly in product technology and packaging. 3. Successful products may soon be counterfeited here.